COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

COMPLAINT OF THE ATTORNEY GENERAL)

TO REDUCE THE ELECTRIC RATES OF) D.T.E. 99-118

FITCHBURG GAS AND ELECTRIC LIGHT)

COMPANY)

MOTION TO DISMISS AND ANSWER

OF FITCHBURG GAS AND ELECTRIC LIGHT COMPANY TO THE

COMPLAINT OF THE ATTORNEY GENERAL

Fitchburg Gas and Electric Light Company ("FG&E" or the "Company") hereby moves for dismissal of the complaint of the Attorney General in the above-referenced matter. Should the Department decide not to dismiss the complaint, FG&E also provides herein its Answer to the Attorney General's Complaint, as required by the Hearing Officer's Procedural Schedule.

I. INTRODUCTION

A. Procedural Background

On December 31, 1999, the Attorney General of the Commonwealth of Massachusetts ("Attorney General") filed with the Department of Telecommunications and Energy ("Department") a complaint ("AG Complaint") against FG&E under G.L. c. 164, sec. 93. The Complaint alleges that FG&E overearned, relative to its overall allowed rate of return, in 1997 and 1998. AG Complaint at 3. The Complaint further asserts that there were "suggestions" that the Company's earnings for 1999 "would exceed any generous estimate of the Company's cost of its capital." See AG Complaint at 3.

On November 15, 2000, the Department scheduled a public hearing and a procedural conference for a Department investigation into the Attorney General's claim that the Company had overearned in 1999. See Notice of Public Hearing, Fitchburg Gas and Elec. Light Co., D.T.E. 99-118 at 1 (Nov. 15, 2000). On December 14, 2000, the Department conducted a public hearing in the City of Fitchburg, Massachusetts. On December 19, 2000, the Department held its procedural conference and at that time requested that the parties submit to the Department proposals for a preferred schedule for an investigation into the Attorney General's Complaint.

On December 22, 2000, the Attorney General filed a letter demanding that the Company file an answer to the Complaint and that the Department act on that answer within ten (10) days. Letter to M. Cottrell from Assistant Attorney General Dean, 12/22/00 ("12/22/00 Letter") at 2. On January 5, 2001, the Department issued a procedural schedule that, among other things, commenced discovery, established a date for the Company's answer and for the prefiling of the Attorney General's direct testimony. Procedural Order, D.T.E. 99-118 (Jan. 5, 2001). On January 9, 2001, the Attorney General issued his standard discovery requests typically submitted in response to a Company's request for a rate increase. This initial request includes 89 multipart questions that appear to assume completion of a cost of service study and identification of a test year. On January 11, the Attorney General issued a second set of data requests, essentially asking the Company to prepare a cost of service study.

On January 9, 2001, the Hearing Officer issued Ground Rules for the proceeding that requires responses to data requests to be provided within five (5) days. The Department also issued its first set of data requests on January 10, 2001, seeking information on the Company's 1999 books and expenses.

B. Summary of Complaint and Responses

1. The Attorney General's Complaint

The Attorney General's Complaint asks the Department to institute an investigation into FG&E's 1999 electric distribution rates, rate of return and depreciation accrual rates. AG Complaint at 5. The facts alleged by the Attorney General include: (1) FG&E's return on electric operations in 1997 was "well above" its 1997 overall return, "as evidenced by [FG&E's 1998] request for a significant increase in gas division rates[]" (AG Complaint at 3); (2) in 1998 FG&E earned a return on average common equity higher than its allowed rate of return (AG Complaint at 3); (3) "preliminary results" indicated that in 1999 FG&E would exceed "any generous estimate of the Company's cost of its capital" (AG Complaint at 3); and, (4) "excessive distribution rates and unreasonably high rate of return" in 1999 "and years prior thereto" was the result of "excessive earnings and underaccrual of depreciation on distribution assets," which depreciation accrual rates are among the lowest in the state. (AG Complaint at 4). The Attorney General also asserts that different rates of return had been established for other companies in other rate proceedings. AG Complaint at 3. Now, in 2000 and in 2001, the Attorney General demands an immediate rate reduction. Tr. 12/19/00 at 12, lines 12-13; 12/22/00 Letter at 1.

The Attorney General filed no supporting affidavits or testimony with his complaint. In the intervening twelve months since submitting his five-page complaint he has also failed to produce any evidence to prove his case. At the procedural hearing on December 19, 2000, and in his December 22, 2000, filing, the Attorney General asserted that his five-page complaint established a *prima facie* case that the Company's rates are unjust and unreasonable. Tr. 12/19/00 at 6; 12/22/00 Letter at 1. Based upon this *prima facie* case, the Attorney General asks the Department to immediately order a rate reduction. Id.

The Attorney General stated at the procedural conference that "[w]e don't think much evidence needs to be taken". Tr. 12/19/00 at p. 6. Based upon his claim that he has made a *prima facie* case for a rate reduction, the Attorney General suggested that briefs be filed on the issue of burden of proof. He further asserts that the Company now has the burden to show that its rates are not unjust and unreasonable and that the Company has fully mitigated its costs. Tr. 12/19/00 at p. 7.

2. FG&E's Response

Mr. George R. Gantz, Senior Vice President of Unitil Service Corp., responded to the Attorney General's complaint at the public hearing on December 14, 2000. Mr. Gantz noted a number of significant factors that demonstrate that neither a rate investigation nor an immediate rate reduction is necessary or appropriate. These factors include:

1. FG&E has not sought to increase its base rates for electric customers since 1984 - an accomplishment achieved by no other Massachusetts electric company. Tr. 12/14/00 at p. 15.

2. FG&E provided its customers with a voluntary rate decrease in 1993. Tr. 12/14/00 at p. 17.

3. In 1991 FG&E merged with Unitil Corporation. Rather than seeking to amortize and defer the cost of that merger for future recovery, as have most Massachusetts utilities that have completed a merger in the last ten years, FG&E's shareholders absorbed all of the costs of the merger. Tr. 12/14/00 at pp. 19-21.

4. FG&E's improved earnings for its electric division since 1991 reflect the benefits of cost control and consolidations from the merger with Unitil. Id.

5. The Department is pursuing implementation of performance based rates for all distribution companies, which process is likely to require review of a cost of service to establish cast off rates. The Department should review FG&E's electric rates in the context of the PBR proceeding rather than pursuing a costly and repetitive rate investigation in response to the Attorney General's complaint. Id.

At the procedural hearing in this matter, the Company further responded to the Attorney General's complaint and his request that the Department order an immediate rate reduction. The Company's representative noted that since 1998, the year on which the Attorney General bases his complaint of overearnings, there have been significant developments which impact the Company's cost of service. These include:

1. A number of decisions by the Department which have the net impact of reducing the Company's revenue. Tr. 12/19/00 at p. 8.

2. The Company's largest customer, accounting for about 10 percent of its revenues, declared bankruptcy and closed. Tr. 12/19/00 at p. 8.

3. The Company has not sought to increase its base electric rates since 1984 and in 1993 requested, and was granted, a base rate decrease. Tr. 12/19/00 at p. 9.

While FG&E noted that the Attorney General carries the burden of proof in this Section 93 case, the Company also stated that if the Department decides to pursue a full rate investigation, it should start with cost of service studies produced by the Company. The Company offered to file cost of service studies and rate cases for both its electric and gas division no later than May 15, 2001.[(1)]

II. MOTION TO DISMISS

FG&E moves to dismiss the Attorney General's complaint, because (1) the Attorney General has failed to plead a factual, or *prima facie*, case that FG&E's distribution rates for electric operations (when examined appropriately on a prospective basis) are unjust and unreasonable; (2) the Attorney General has failed to plead facts in the Complaint upon which a claim for emergency or interim rate relief could be granted by the Department; and (3) the Attorney General has failed to plead facts sufficient to grant relief under G.L. c.164, sec. 93.

A. Standard of Review for Motion to Dismiss

According to the Department's Rules of Practice, "[a] party may move at any time after the submission of an initial filing for dismissal . . . as to all issues or any issue in the case." 220 C.M.R. 1.06(6)(e). The Department has stated that when it rules on a Motion to Dismiss, or upon a request for dismissal based on failure to state a claim upon which relief can be granted, the Department will take the facts included in the initial pleading as true and viewed most favorably to the non-moving party. Stow Municipal Light v. Hudson, D.P.U. 93-124-A at 5 (1993). Further, if a bona fide controversy exists, the movant must demonstrate affirmatively, to the Department's satisfaction, that the petitioner is "not entitled to relief under any set of well plead facts that could be proved in support of the petition." See, Riverside Steam & Elec. Co., D.P.U. 89-123 at 26-27 (1988); see also Eyal v. Helen Broadcasting Corp., 411 Mass. 426, 429, 583 N.E.2d 228 (1991); see also Nader v. Citron, 372 Mass. 96, 98, 360 N.E.2d 870 (1977) quoting Conley v. Gibson, 355 U.S. 41, 45-46, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957). See also Whitinsville Plaza, Inc. v. Kotseas, 378 Mass. 85, 89, 390 N.E.2d 243 (1979). The Department has described this standard as consistent with the traditional Rule 12(b)(6) civil standard. Stow, D.P.U. 93-124-A at 5, citing Riverside Steam, id.; Mass. R. Civ. P. Rule 12(b)(6).[(2)]

B. The Attorney General's Complaint Fails to State a Case for Which the Requested Relief May Be Granted.

The relief which the Attorney General seeks from his complaint is an immediate reduction in FG&E's electric rates based solely upon his *prima facie* case which allegedly shows unjust and unreasonable rates in 1998. Tr. 12/19/00 at p. 6. Notwithstanding the failure of the Attorney General to submit any testimony or affidavits during the past year to support his case, or to even update his 1999 pleadings, the Department is precluded, as a matter of law, from granting the relief requested. The Department should dismiss the Attorney General's request to ignore any semblance of due process and impose a single-issue rate case adjustment based upon stale data.

1. The Attorney General Failed to Plead Facts that Demonstrate FG&E's 2000 or 2001 Rates Were, or Would Be, Unreasonable or Illegal

It is well settled law that the Department's power to regulate public utility rates is limited by a utility's constitutional right to a fair and reasonable return on investment. Boston Gas Co. v. Department of Pub. Utils., 368 Mass. 780, 789-790 (1975). A return is fair and reasonable if it covers utility operating expenses, debt service, and dividends, if it compensates investors for the risks of investment, and if it is sufficient to attract capital and assure confidence in the enterprise's financial integrity. FPC v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944), cited in Mystic Valley Gas Co. v. Department of Pub. Utils., 359 Mass. 420, 424 (1971). In addition, the Department's rate setting powers are circumscribed by the standards enumerated in G. L. c. 30A, Section 14 (7).[3]

Under Massachusetts's law, the complaining party seeking a change to existing rates carries the burden of proving new rates. Fryer v. Department of Public Utilities, 374 Mass. 685, 690 (1978). It is also well settled that a utility that alleges confiscatory or otherwise unlawful rates has the burden of proof on its allegations. See Wannacomet Water Co. v. Department of Pub. Utils., 346 Mass. 453, 463 (1963); New England Tel. & Tel. Co. v. Department of Pub. Utils., 327 Mass. 81, 91 (1951). Similarly, the Attorney General in this proceeding, as the complainant, bears the burden of proving that new rates are just and reasonable. See Fryer v. Department of Public Utilities, 374 Mass. 685, 690 (1978). Thus, FG&E respectfully submits that, to obtain the relief the Attorney General requests, the Complaint must plead facts that clearly allege the Company's prospective return will constitute an illegal effective return on investment.

The concept of a "return," as used in this manner, is intended to describe FG&E's electric operations distribution revenue requirements including operating expenses and capital costs. See Fitchburg Gas and Elec. Light Co. v. Department of Pub. Utils., 371 Mass.

881, n. 5 (1977). The Department computes revenue requirements by valuing rate base and establishing a rate of return, which is then applied to the rate base. Id.; see also AG Complaint at Attachment A (calculation for 1998). Together these computations yield a return on investment. Id. A utility's income can be increased, on a prospective basis, either by increasing its rate base or by increasing its permissible rate of return. Id., citing, J.C. Bonbright, Principles of Public Utility Rates 149-153 (1961).

FG&E submits that the Attorney General must demonstrate that the claimed "discrepancy between authorized rates of return and effective rates of return is more than a transient phenomenon which rate levels cannot address." Fitchburg, 371 Mass. 881, n. 5, 885, 889 citing J.C. Bonbright, Principles of Public Utility Rates, at 150-151 (1961). This is because rates are designed prospectively, and because rates are not intended to match a dollar for dollar recovery, either for the Company or for its ratepayers. In other words, rates are designed routinely to yield a reasonable rate of return on the average, over a period of time. Id. Applications for new rate schedules, or challenges to existing rates, must be designed "to realign experience with a theoretical average." Id.

Therefore, to survive this Motion, the Attorney General's Complaint must have plead that, first, the discrepancy he discerns is permanent and illegal; second, that lowering the allowed rate of return, or changing the amortization of depreciation, is an appropriate method for handling an otherwise illegal effective return on investment; and third, that the resulting rates are not illegal and confiscatory for FG&E but will be sufficient to cover utility operating expenses, debt service, and dividends, will compensate investors for the risks of investment, and be sufficient to attract capital and assure confidence in the enterprise's financial integrity.[(4)] See Fitchburg, 371 Mass. at 885, 889 (appellant did not make the requisite showing that return was confiscatory), citing FPC v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944).

The Attorney General has plead insufficient facts to support these findings, and thus the Company's Motion to Dismiss should be granted.

2. The Complaint is a Look Back, Not a Look Forward

The Attorney General pleads facts relative to 1997, facts relative to 1998, and, taken in the light most favorable, facts relative to 1999 (see AG Complaint at 3). The Attorney General failed to state facts to show that FG&E's current or prospective electric distribution rates, its rate of return or its depreciation accrual rates are unjust and unreasonable. Indeed, the Attorney General wholly ignores the fact that the Company's last base rate increase was in 1984, and makes no attempt to account for changes in the Company's costs and revenues.

Moreover, the Attorney General complained on December 31, 1999 that FG&E had "excessive earnings during calendar year 1999." AG Complaint at 1. However, in order to file his complaint, the Attorney General necessarily arrived at this conclusion before the end of 1999. The Attorney General's Complaint asserts that "preliminary financial

results[ ] suggest" that the Company will overearn for 1999. AG Complaint at 3. He does not plead that the Company's rates in 1999 were not just or reasonable.

As discussed above, rates are set prospectively. Lowell Gas Co. v. Attorney General, 377 Mass. 37, 45, 385 N.E.2d 240, 246 (1979); Boston Edison Co. v. Department of Pub. Utils., 375 Mass. 1, 6, 375 N.E. 2d 305, 312 (1978); Fryer v. Department of Pub. Utils., 374 Mass. 685, 373 N.E. 2d. 977 (1978). Complaints about past years, as contained in the Attorney General's Complaint, are not conclusive as to whether prospective rates are illegal. Furthermore, rates are set upon the individual examination of a company's revenues and costs. Complaints about other company's allowed return, as contained in the Attorney General's Complaint at p. 3, are irrelevant to a determination about whether prospectively any return for FG&E is illegal.

If FG&E had filed a traditional rate proceeding under G.L. c. 164, sec. 94, it would be required to demonstrate that its electric division test year rates (1999 or 2000), pro formed for the rate year (e.g. allowed just and reasonable adjustments to reflect prospective impact on 2001) would produce an unreasonable deficit of revenues required to operate the electric division during the rate year. If FG&E were able to meet that burden, FG&E would be successful in convincing the Department that its current rates were not just and reasonable on a going-forward basis and must be changed. Rate relief in these circumstances would be appropriate under law. Failure to provide relief would result in an illegal and unconstitutional rate.

Because the Attorney General has the burden in this petition, the Attorney General must make the converse showing. The Attorney General's petition must demonstrate that FG&E's test year rates (e.g. 1999 or 2000), pro formed for the rate year (e.g. examined for its prospective impact) would produce revenues that were unreasonably high compared to the revenues required to earn a reasonable return on investment during the rate year. Whether a company has over or underearned must be determined in the context of all of its costs and revenues, and can not be assessed outside of a full and contemporary cost of service study. The Department has repeatedly rejected attempts to adjust rates for a single issue. See Mass-American Water Co., D.P.U. 95-118 at 175 (1995); Fitchburg Gas and Electric Light Co., DTE 97-115/98-120 at 39 (1999); New England Tel. & Tel., D.P.U. 97-18-A at 8 (1997); Housatonic Water Works, D.P.U. 95-81 at 3 (1996); Boston Edison Co. D.P.U. 92-23/92-24 (1992).

The precedent cited by the Attorney General contradicts, rather than supports his claim that he has made a *prima facie* case and that the burden has now shifted to the Company to demonstrate its rates are just and reasonable. In Colorado Interstate Gas Company, the United States Court of Appeals for the 10th Circuit found that the FERC, and other parties seeking a rate change, had the burden of proving not only that the existing rate was unjust and unreasonable, but also that their proposed rate adjustment was just and reasonable. 904 F.2d 1456, 1459 (1990). This proposed rate change was not reviewed in the context of a single issue rate case, but rather as part of an overall review of the companies base rates, including a review of the utility's full cost of service. 41 FERC ¶ 61,179, p. 61, 454 (1987).

The FERC relied not merely upon the pleadings of one party for its prima facie determination, but upon a series of prior reviews and orders, as well as upon the hearing testimony of expert witnesses. See 904 F.2d 1456, 1460; 41 FERC ¶¶ 61,179, 61,465.[(5)] In contrast, the Attorney General has provided no supporting testimony and bases his request for an immediate rate reduction entirely upon his initial pleadings. The decisions by the FERC and the appeals court in Colorado Interstate Gas Company demonstrate that the Attorney General has yet to meet his burden of proof and that the Department should only consider adjusting rates prospectively in the context of a full base rate proceeding.

Therefore, the Attorney General has failed to meet his *prima facie* burden. The relief that is sought by the Complaint cannot be granted under the facts presented in the Complaint. Dismissal is proper.

C. The Complaint Should be Dismissed Because the Attorney General Failed to Plead Facts that Warrant or Meet the Standard for Interim or Emergency Rate Relief

1. Standard of Review for Emergency Rate Relief

The Attorney General asked the Department to act immediately to lower FG&E's rates for its electric division. Tr. 12/19/00 at 6; Letter 12/22/00. Because the grant of interim rate relief "necessarily means that the Department must act without a full hearing and without subjecting the proposed rate filing to the close scrutiny that takes place during the full period of suspension," grants of emergency relief are extremely rare. See Hammond Acres Water Co., D.P.U. 96-37 at 2 (1996). The Department limits interim rate relief to instances where "a genuine financial emergency exists and when interim relief is necessary to avoid probable, immediate and irreparable harm either to a company or to the interests of its customers." Id, citing CSB Water Co., D.P.U. 91-101, Interim Order at 1-2; Western Massachusetts Elec. Co., D.P.U. 1300 at 9-10 (1983); Fitchburg Gas and Elec. Light Co., D.P.U. 1270/1414 at 9 (1983).

The Department has also held that interim relief can only be granted where a demonstration has been made that the amount and terms of the requested assessment (or in this case, reduction) are just and reasonable. McNamara Water Serv., D.P.U. 91-196 at 3 (1992), citing CSB Water Co., D.P.U. 91-101, Interim Order at 1-2; Duck Farm Springs, D.P.U. 89-259 at 5 (1990); Wylde Wood Water Works, D.P.U. 86-93 at 6-9 (1987); FG&E, D.P.U. 1270/1414 at 9.

2. The Attorney General Failed to Plead Facts to Meet this Standard

In his Complaint, the Attorney General alleges that FG&E's rates result from "excessive earnings" (as compared, inter alia, to the 11 percent established for other companies in 1993 and 1995, and FG&E's gas operations in 1998) and the "associated under accrual for depreciation of its distribution assets, in calendar year 1999 and years prior thereto." AG

Complaint at 4. However, in order to establish facts that would support a claim for emergency relief, the Attorney General would have to plead that 2000 (or now 2001) rates were so unreasonable as to make them unlawful. He would have to plead facts that demonstrate that there was no likelihood that such returns were tentative, as Bonbright recognizes, but would continue to repeat year after year after year. Fitchburg Gas and Electric Light Co. v. Department of Public Utilities, 371 Mass. 881, 889 (1977) ("more than a transient phenomenon").

The Attorney General also would have to plead facts that demonstrate that the rate level proposed would elicit a reasonable amount for a reduction. In addition the Attorney General would have to plead facts that demonstrate that the amount of reduction (in order to eliminate the claimed illegality) would eliminate the claimed exigency but not be confiscatory to FG&E.

The Attorney General plead no facts to support his claim for emergency rate relief. Accordingly, it is appropriate to dismiss the Complaint.

D. The Complaint Is Not An Appropriate Action Under Section 93

As a result of restructuring, FG&E is no longer engaged in the generation, supply and sale of electricity. Section 93 was not amended as a result of St. 1997, ch. 164 and authorizes the Department to consider complaints regarding "the price or prices of... electricity". A threshold legal question is whether section 93 is applicable to the distribution rates of a restructured distribution company, particularly given that its earnings are no longer tied to the "price of electricity". On its face, the Attorney General's complaint does not address the price of electricity and therefore fails to state a claim for which relief may be granted under section 93 of G.L. 164.

Section 93 reads, in pertinent part, as follows:

On written complaint of the attorney general, . . . as to the . . .price of . . . electricity sold and delivered, the department shall notify said company by leaving at its office a copy of such complaint, and shall thereupon, after notice, give a public hearing to such complainant and said company, and after such hearing may order any reduction or change in the price or prices of . . . electricity . . ., and a report of such proceedings and the result thereof shall be included in the report required by section seventy-seven. The department may likewise make such an order, after notice and hearing as aforesaid, upon its own motion. The price or prices fixed by any such order shall not thereafter be changed by said company except as provided in section ninety-four.

In contrast to Section 93, which is limited to actions concerning the "price of electricity", Section 94 provides for the filing and review by the Department of any rates, prices and charges "for the sale and distribution of gas or electricity." In interpreting these consecutive sections of Chapter 164, the Department must give meaning to the different statutory language and more limited scope used by the General Court in Section 93. See Beeler v. Downey, 387 Mass. 609, 616 (1982) (where legislature employs specific language in one paragraph, but not another, language should not be implied where it is not present).

In this action, the Attorney General does not seek to adjust the "price of electricity," which is now a separate and distinct component of an electric customer's bill. The price of electricity, following electric industry restructuring, is established by the competitive market. A customer may purchase electricity from a third party supplier at a price established by that supplier in the competitive market,. or a customer may take standard offer service or default service, the price of which is established when the electric distribution company conducts a wholesale solicitation for such supplies under the Department's supervision.

The Attorney General's complaint does not seek to adjust the price of electricity, but rather to reduce the unbundled rates which FG&E charges for distribution service. While this is an appropriate matter for the Department's investigation, the facts plead by the Attorney General do not sound as an action under Section 93. Accordingly, the Attorney General's complaint should be dismissed.[(6)]

III. ANSWER

In the event the Department does not dismiss the Attorney General's complaint, FG&E hereby files the following Answer to the Attorney General's complaint.

A. First Defense: Failure to State a Claim for Which Relief May Be Granted

The complaint fails to state a claim against FG&E upon which relief may be granted. See infra Motion to Dismiss of FG&E, pp. 1-15.

B. Second Defense: Admissions and Denials

FG&E admits the allegations contained in paragraphs 3, 4, 5 and 6 of the complaint; admits the allegation contained in the second sentence of paragraph 9 of the complaint and denies the other allegations contained in the complaint.

C. Third Defense: The Department Should Not Endorse a Single Issue Rate Case

The Attorney General seeks to "reduce rates for consumers who are electric utility ratepayers of Fitchburg Gas & Electric Light Company, due to the [FG&E's] excessive earnings during calendar year 1999." See Paragraph 1 of Complaint. The Attorney General's "Income Statement Methodology" for determining FG&E's earned returned fails to demonstrate "excessive earnings". Before ordering a reduction in rates, as sought by the complaint, the Department must consider the full cost of service of the Company and the impacts of known and measurable pro forma adjustments that will effect the Company's expenses and revenues during the succeeding rate year. The complaint's allegation that FG&E's earnings are excessive fails to consider contravening expense and revenue impacts including the loss of FG&E's largest single customer, prior and potential disallowances by the Department, capital additions and increased costs including labor costs, employee benefit costs and other known and measurable cost increases.

The Company has not conducted a cost-of-service study as would be required to investigate its rates, but has offered to do so. Because rates are set prospectively, not retroactively, it would be inappropriate to go back and investigate rates in prior years (1999) unless this investigation leads to setting rates for the future. If the Department pursues this investigation, the Company believes it is appropriate to use a 2000 test year to investigate its rates.

The Department has long standing procedures for the review of proposed base rate adjustments, including: notice, use of test years, allowable expenses, calculation of rate base, determination of cost of capital, allowance for "rate year" pro-forma adjustments, and due process requirements. Base rates are not changed based on a "back of the envelope" calculation as proposed by the Attorney General, but rather are subject to review under a comprehensive set of rules, procedures and regulations that are designed to provide due process protections to all of the parties and ultimately to allow for the determination of just and reasonable rates. The Attorney General's suggestion that base rates may be adjusted for a single issue and without consideration of a full range of

evidence regarding the Company's cost of service is contrary to Department precedent and constitutional requirements.

D. Fourth Defense: The Attorney General's Ratemaking Proposal is Flawed

The Attorney General has used return numbers based on a self-described Income Statement Methodology (Attachment A of the Complaint) that is not based upon Department precedent and has never been used in setting rates. The Attorney General's complaint does not rely on traditional cost of service calculations for determining operating expenses, rate base and cost of capital. The complaint is flawed in that it treats interest expense "above-the-line" and uses unsupported allocations to develop a "back of the envelope" approach to the Company's cost of service and rate of return. Moreover, this analysis fails to differentiate and unbundle the Company's cost of service related to distribution service and the Company's cost of service related to transmission, generation, Seabrook abandonment and unregulated activities (water heater program). There is no way to determine the adequacy or inadequacy of distribution company cost of service from the Attorney General's analysis, which is at best speculative and judgmental.

The Company agrees that it has achieved good, but not excessive, overall financial returns in the years 1997 and 1998. But it is important to understand and underscore the source of this financial performance and the context that they have been achieved. First, these earnings are not due to rate increases implemented by the Company. To the contrary the Company has not had a base rate increase in its electric operations since 1985 and in fact unilaterally reduced rates in 1993. It had its first gas operation rate increase in over 17 years in 1998, and despite this increase continues to experience disappointing returns for its gas operations. The Company has among the lowest gas rates in the Commonwealth. In comparison to other utilities in the Commonwealth, the Company's record of avoiding increases in base rates and the overall change in its rates since its last rate increase is unmatched.

In 1989 FG&E had the highest electric rates in Massachusetts. In the subsequent decade, however, FG&E significantly improved its competitive position relative to the other Massachusetts utilities. Over this period, FG&E's electric rates were relatively stable and increased a total of only 4 percent; during the same period the rates of other Massachusetts electric utilities increased by a total of 20 to 50 percent.

Rather than being driven by rate increases, the Company's overall good financial performance reflects the success of its merger with Unitil in 1992. Following the merger, the Company achieved operating efficiencies and successfully implemented operating consolidations involving almost all the major distribution operations including: engineering, accounting, customer operations, customer service, information technology, finance and regulatory services. Through these achievements the Company has been able to reduce its cost of operations and avoid cost increases to its customers. At the same time, the Company has reinvested resources in FG&E to improve customer service and system reliability. This financial performance did not come without a cost to the

Company. FG&E incurred approximately $5.5 million in expenses related to its merger with Unitil, for which it neither requested nor received cost recovery from ratepayers.

The Attorney General's analysis is also flawed because it fails to recognize that a substantial portion of earnings in the period referenced is due to impact of a single large customer (Princeton Paper) that contributed $667,837, $700,560 and $1,534,820 to net distribution base revenue in 1997, 1998 and 1999, respectively. To FG&E's relatively small total system electric load of approximately 90 MW, a single large customer with a load of up to 20 MW has a significant impact on the earnings of the Company. While this same customer supported the financial performance of the Company in the years identified by the Attorney General, this customer has now declared bankruptcy and no longer contributes to that financial performance. Any assessment of the Company's future costs and revenues must recognize and remove the significant revenue contribution previously made by this single customer.

In addition, the Attorney General fails to take into account a number of recent Department decisions that directly impact the evaluation of the Company's performance in these years, including: 1) the negative impact of the Company's write-off of an additional $1.5 million of its abandoned Seabrook Asset as required by the Department's restructuring order (a portion of which is reflected in earnings in 1997 and 1998 data, but subsequently disallowed by the Department); 2) the MDTE order to disallow recovery of more than $335,000 of lost base revenues associated with the Company's conservation and load management programs, (recorded in 1998/99 revenue and earnings, but subsequently written off in 2000); and 3) adjustments to stranded cost recovery agreed to by the Company in MDTE 99-110 (recorded in 1998/1999 revenues, expenses and earnings, but subsequently reversed in 2000). The Attorney General also ignores the potential impact of pending proceedings before the Department, where he has argued for significant disallowances and refunds that could significantly impact the Company's revenues.

In addition the Attorney General has failed to consider the impact of known and measurable increases in operating costs such as wages and salaries, pension costs, health care costs and other inflationary cost increases. The Attorney General has also failed to account for significant post "test-year" rate base additions, including the recent completion of a new 69-13.8 kV substation (designated as Sawyer Passway S/S) in 2000 and extensive distribution modifications to be completed in early 2001 as part of this $6.0 million dollar project. Nor has the Attorney General offered any expert analysis of the Company's cost of capital, its required rate of return, or other studies necessary for determining just and reasonable rates. The Attorney General presents no financial information relative to 1999, but only indicates he has undertaken a "preliminary" examination. He has never filed follow-up information to support his base assertions.

E. Fifth Defense: Depreciation Rates Should Be Addressed in the Context

of a Base Rate Case

A change in the Company's depreciation rates requires Department review and approval, and is generally addressed in the context of a base rate case. Because the Company has successfully run its operations in the absence of a base rate proceeding for such an extended period, it is agreed that it would be appropriate to review FG&E's depreciation rates. The Company planned to address depreciation rates as part of the PBR ratemaking process and had a depreciation study conducted for its gas and electric operation in 1998.

Changes in depreciation rates do not necessarily produce lower rates for customers, and in fact, are most often accompanied by a request for rate increases to cover the additional accural. In the 1998 base rate case for the Company's gas division, the Attorney General sought to strike from the record that portion of the depreciation study which also addressed its electric division. This request was denied by the Department, which made no findings in regard to electric depreciation rates in that proceeding. Nevertheless, it is appropriate only for the Company's depreciation rates to be reviewed in the context of a full base rate investigation.

WHEREFORE, for the reasons stated above and as more fully detailed in the Motion to Dismiss, FG&E seeks judgment that the complaint be dismissed, or in the alternative, that the Department provide for a procedural schedule to allow the Company to present a full cost of service study and appropriate adjustments for a future rate year in order to make a fair and equitable assessment of the Companies future earnings levels.

Respectfully submitted,

FITCHBURG GAS AND ELECTRIC LIGHT

COMPANY

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1.

[1] In response to the Company's offer to file cost of service studies, the Attorney General indicated that it was his preference not to file testimony prior to the Company's filing of a rate case. Tr. p. 13. Rather, the Attorney General rests on this initial complaint and seeks an order from the Department for an immediate rate reduction.

2.

[2] Under the rules of Civil Procedure, a Rule 12(b)(6) Motion must be filed in lieu of an answer to the Complaint, or the opportunity to so respond is lost.

3. [3] G.L. c. 30A, sec. 14(7) states, in pertinent part, that the Court may remand a decision of the Department, set aside or modify a decision of the Department or ensure substantial justice is done by a decision of the Department if the order was ultra vires, in violation of the constitution or statutory provisions, based on an error of law or unlawful procedure, unsupported by substantial evidence, or arbitrary and capricious. "Substantial evidence" means such evidence as a reasonable mind might accept as adequate to support a conclusion. G.L. c. 30A, sec. 1(6).

4.

[4] "The Massachusetts Constitution does not require use of any specific economic theory or method of return computation, except to the extent that improper exclusion of an investment from valuation of a rate base denies a return on that investment." Fitchburg, 371 Mass. 881, n. 5, citing in part New England Tel. & Tel. Co. v. Department of Pub. Utils., 360 Mass. 443, 453 (1971); New England Tel. & Tel. Co. v. Department of Pub. Utils., 331 Mass. 604, 616 (1954).

5.

[5] It is also noteworthy that in establishing the new rate sought by FERC staff, the FERC found that it was appropriate to only make the new rate effective prospectively, following suspension, hearings and a final order. 41 FERC ¶¶ 61,179, p. 61,466.

6.

[6] Under its plenary supervisory authority, the Department may order FG&E to file a base rate case. In such case, FG&E must be afforded due process rights for the preparation of such a filing, including a full cost of service study. Should the Department determine that an investigation of FG&E's base rates is appropriate, such investigation should start with filing of an initial rates and case by the Company.